

**AUDIT OF THE
BREATHITT COUNTY FISCAL COURT**

Fiscal Year Ended June 30, 2005

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Management's Discussion and Analysis

June 30, 2005

The financial management of Breathitt County, Kentucky offers readers of Breathitt County's financial statements this narrative overview and analysis of the financial activities of Breathitt County for the fiscal year ended June 30, 2005. We encourage readers to consider the information presented here in conjunction with other information that we have furnished in our letter of transmission and the notes to the financial statements.

Financial Highlights.

- Breathitt County had net assets of \$8,587,592 as of June 30, 2005. The fiscal court had unrestricted net assets of \$2,665,464 in the governmental funds as of June 30, 2005. Cash and cash equivalents were with total assets of \$2,249,764. Total debt for governmental funds principal as of June 30, 2005 was \$9,010,317 with \$868,279 due within one year.
- The governmental fund's total net assets increased by \$721,130 from the prior year.
- At the close of the current fiscal year, Breathitt County governmental funds reported current assets of \$2,665,464. Of this amount, \$776,119 is available for spending at the government's discretion (unreserved fund balance).
- Breathitt County's total indebtedness at the close of fiscal year June 30, 2005 was \$9,010,317, of which \$8,142,038 is long-term debt (due after 1 year) and \$868,279 is short-term debt (to be paid within 1 year). Debt additions were \$150,000, and debt reductions were \$547,634 for a net Decrease of \$397,634 for the year.

Overview of the Financial Statements.

This management discussion and analysis is intended to serve as an introduction to Breathitt County's basic financial statements. Breathitt County's basic financial statements comprised of three components: 1) government wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

GASB 34 requires management to include certain comparison schedules when they are available. The schedules include prior and current comparisons of general revenues by major source, and program expenses by function. This is the second year of implementation and these schedules will be presented next year.

Breathitt County
Management's Discussion and Analysis
June 30, 2005
(Continued)

Government-wide Financial Statements. The government-wide financial statements are designed to provide the readers with a broad overview of Breathitt County's finances, in a manner similar to a private-sector business.

The *Statement of Net Assets* presents information on all of Breathitt County's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of Breathitt County is improving or deteriorating.

The *Statement of Activities* presents information showing how the government's net assets changed during the fiscal year. All changes in net assets are reported on a modified cash basis of accounting. Basis of accounting is referred to when they result from a cash transaction, except for the recording of depreciation expenses on capital assets in the government-wide financial statements for all activities and in the fund financial statements for the proprietary fund financial statements.

As a result of the use of the modified cash basis of accounting, certain assets and their related revenues (such as amounts billed for services provided, but not collected) and accounts payable (expenses for goods and services received but not paid) or compensated absences are not recorded.

Both of the government-wide financial statements distinguish functions of the County that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or significant portion of their costs through user fees and charges (*business-type activities*). Breathitt County's governmental activities include general government, protection to persons and property, roads, recreation, social services, airport, debt service, capital projects, and administration. Breathitt County has no business by type activity.

Fund Financial Statements. A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. Breathitt County, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of Breathitt County can be divided into broad categories: *governmental funds and proprietary funds*.

Governmental Funds. Governmental funds are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statement. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spend able resources, as well as on balances of spend able resources available at the end of the fiscal year. Such information may be useful in evaluation a government's near-term financing requirements.

Governmental Funds (Continued).

Because of focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

Breathitt County maintains (12) twelve individual governmental funds. Information is presented separately in the governmental fund budget sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances.

Major Funds:

- General Fund
- Road Fund
- Breathitt County Kentucky Justice Center Corporation Bond Fund
- Breathitt county General Obligation Refunding Bond Series 2003 Fund

Non-Major Funds:

- Jail Fund
- Local Government Economic Assistance Fund
- C.D.B.G. Fund
- D.E.S.
- Solid Waste Fund
- E-911 Fund
- Local Government Economic Development Fund
- Breathitt County Public Properties Bond Fund

Breathitt County adopts an annual appropriated budget. A budgetary comparison statement has been provided for the General Fund, and Road Fund to demonstrate compliance with their budgets.

Notes to the Financial Statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Breathitt County
Management's Discussion and Analysis
June 30, 2005
(Continued)

Net Assets. As noted earlier, net assets may serve over time as a useful indicator of a government's financial position.

Table 1
Breathitt County's Net Assets

	Governmental Activities	
	2004	2005
Assets		
Current and other assets	6,381,614	2,665,464
Capital assets	10,879,850	14,932,445
Total assets	17,261,464	17,597,909
Liabilities		
Current and other liabilities	534,861	868,279
Long-term liabilities	8,873,090	8,142,038
Total liabilities	9,407,951	9,010,317
Net Assets		
Invested in capital assets, net of related debt	1,471,899	5,922,128
Restricted	5,200,984	3,256,664
Unrestricted	1,180,630	2,665,464
Total Net Assets	7,853,513	8,587,592

Governmental Activities. Breathitt County's net assets increased by \$721,130 in fiscal year 2005. Key elements of this are as follows:

- Current assets and cash decreased \$3,716,150, due to expenditures from the Breathitt County Justice Center Corporation Bond Fund.
- Investment in capital assets and infrastructure, net of related debt increased \$4,450,229 due to the increase of construction in progress.
- Current and long-term liabilities decreased by \$397,634 due to reduction in principle.

Breathitt County
Management's Discussion and Analysis
June 30, 2005
(Continued)

Financial Analysis of the County's Funds.

As noted earlier, Breathitt County uses fund accounting to ensure and demonstrate compliance with finance-related requirements.

Governmental Funds Overview. The focus of Breathitt County governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the County's financing requirements. In particular, unreserved fund balances may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of June 2005 fiscal year, the combined ending fund balances of County governmental funds were \$2,665,464. Approximately 100% (\$2,665,464) of this consists of unreserved fund balance, which is available as working capital and for current spending in accordance with the purposes of the specific funds.

The County has (4) four major governmental funds.

Major Funds:

- General Fund
- Road Fund
- Breathitt County Kentucky Justice Center Corporation Bond Fund
- Breathitt County General Obligation Refunding Bond Series 2003 Fund

Non-Major Funds

- Jail Fund
- Local Government Economic Assistance Fund
- CDBG Fund
- D.E.S.
- Solid Waste Fund
- Emergency 911 Fund
- Local Government Economic Development Fund

Breathitt County
Management's Discussion and Analysis
June 30, 2005
(Continued)

1. The General Fund is the chief operating fund of Breathitt County. At the end June 30, 2005 fiscal year, unencumbered fund balance of the General Fund was \$ 571,366.00. The County received approximately 52% of its tax revenue from the 1% occupational tax. A total of \$ 465,254 was received in real and personal property, motor vehicle, and other taxes for approximately 28 % of the county's general revenues. Various other service fees and miscellaneous revenues contribute to the remaining 20 % of revenues. The fiscal year expenditures for the General Fund were \$1,409,415.
2. The Road Fund is the fund related to the County road, bridge construction and maintenance. The Road Fund had an unencumbered cash balance of \$ 275,826 at June 30, 2005. The fiscal year 2005 expenditures for Road Fund were \$ 1,518,982.
3. The Jail Fund is used to account for the operation of the County's detention program. The Jail Fund had a balance at end June 30, 2005 of \$ 25,099. The Jail Fund received \$ 98,069.72 for intergovernmental fees, primarily for housing prisoners. The General Fund contributed \$ 228,000.00 and the L.G.E.A. Fund contributed \$ 188,975.00 to the jail operations.
4. The L.G.E.A. Fund had a balance of \$ 104,858 as of June 30, 2005, for funding of the Coroner's Office and Animal Control.
5. The Federal Grants Fund established for the Life Skills Center had a balance of \$ 0. This fund was established to account for the pass through funds in the amount of \$2,900 from various agencies for construction of the Life Skills Center.
6. The D.E.S. Fund had a balance of \$ 84,579. Breathitt County was designated the Regional Center and received Weapons of Mass Destruction funding in the amount of \$432,987.17.
7. The Solid Waste Fund had a balance of \$109,999.
8. The Emergency 911 Fund accounts for the operation of the City/County emergency operations communications. The fund had a balance of \$104,710 at the end of the June 30, 2005 fiscal year. Tax revenue from telephone and cell phones for the fiscal year was \$91,219.
9. The L.G.E.A. Development Fund had a balance of \$ 2,514.51.

Breathitt County
Management's Discussion and Analysis
June 30, 2005
(Continued)

General Fund Budgetary Highlights.

Breathitt County's budget was amended during the fiscal year increasing the budgeted amount by \$ 1,550,381. Budget Amendments were made to various expenditures due to grants awarded in the fiscal year, surplus cash carried forward, and an increase in actual tax revenue.

Capital Assets and Debt Administration.

Capital Assets. Breathitt County's investment in capital assets for its government and business type activities as of June 30, 2005, amount to \$ 9,504,823 (net or accumulated depreciation). This investment in capital assets includes land, buildings improvements to land other than buildings, machinery and equipment, vehicles, current infrastructure additions. Breathitt County is reporting infrastructure assets per GASB 34 provisions.

Major capital asset events during the 2005 fiscal year included continued construction of the Judicial Center and the purchase of road equipment.

Additional information of the County's capital assets can be found in Note 4 of this report.

Table 2
Breathitt County's Capital Assets, Net of Accumulated Depreciation

	Governmental Activities	
	2004	2005
Infrastructure	321,659	420,608
Land	1,727,786	1,727,786
Construction in Progress	2,300,810	6,271,968
Bldgs. & Improvements	5,850,769	5,820,814
Vehicles & Equipment	658,826	691,269
Total Net Capital Assets	10,879,850	8,587,592

Breathitt County
Management's Discussion and Analysis
June 30, 2005
(Continued)

Long-term Debt. At the end of the 2005 fiscal year, Breathitt County had total bonded debt outstanding of \$ 8,565,000. The totals are as follows: General Obligation Bonds \$ 435,000, and Revenue bonds of \$8,130,000. Breathitt County had other Financing Obligations of \$445,317 to include capital leases and a loan guaranty.

Other Matters. The following factors are expected to have a significant effect on the County's financial position or results of operations and were taken into account in developing the 2005 fiscal year budget:

- The 2006 fiscal year adopted budget continues most services at current levels.
- Program cuts at the State level, particularly relating to the cost of housing prisoners, may have a negative impact on funding for county programs. Jail population continues to increase along with the cost to transport and house prisoners at regional jail facilities outside the county.
- Economic factors indicate a flat rate of growth for the county.
- Health care insurance continues to increase.
- Fuel costs are reaching historic levels.

Requests For Information.

This financial report is designed to provide a general overview of Breathitt County's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this or requests for additional financial information should be addressed to the Breathitt County Treasurer, 1137 Main Street, Jackson, Kentucky 41339.

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To the People of Kentucky
Honorable Ernie Fletcher, Governor
John R. Farris, Secretary
Finance and Administration Cabinet
Honorable Lewis H. Warrix, Breathitt County Judge/Executive
Members of the Breathitt County Fiscal Court

Independent Auditor's Report

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of Breathitt County, Kentucky, as of and for the year ended June 30, 2005, which collectively comprise the County's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Breathitt County Fiscal Court. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, and the Audit Guide for Fiscal Court Audits issued by the Auditor of Public Accounts, Commonwealth of Kentucky. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As described in Note 1, Breathitt County, Kentucky, prepares its financial statements on a prescribed basis of accounting that demonstrates compliance with the modified cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of Breathitt County, Kentucky, as of June 30, 2005, and the respective changes in financial position, where applicable, thereof for the year then ended in conformity with the basis of accounting described in Note 1.

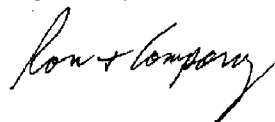
The management's discussion and analysis and budgetary comparison information are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

To the People of Kentucky
Honorable Ernie Fletcher, Governor
John R. Farris, Secretary
Finance and Administration Cabinet
Honorable Lewis H. Warrix, Breathitt County Judge/Executive
Members of the Breathitt County Fiscal Court
(Continued)

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Breathitt County, Kentucky's basic financial statements. The accompanying supplementary information, combining fund financial statements are presented for additional analysis and are not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments and Non-Profit Organizations, and is not a required part of the basic financial statements. The combining fund financial statements and the schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation of the basic financial statements taken as a whole.

In accordance with Government Auditing Standards, we have also issued our report dated April 3, 2006 on our consideration of Breathitt County, Kentucky's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Respectfully submitted

A handwritten signature in cursive script, appearing to read "Ross & Company", written in dark ink.

Ross & Company, PLLC

Audit fieldwork completed-
April 3, 2006

BREATHITT COUNTY OFFICIALS

Fiscal Year Ended June 30, 2005

Fiscal Court Members:

Lewis H. Warrix	County Judge/Executive
James W. Combs	Commissioner
Steve Banks	Commissioner
Arch Turner	Commissioner

Other Elected Officials:

Brendon D. Miller	County Attorney
James E. Turner	Jailer
Tony Watts	County Clerk
Thomas E. Howard	Circuit Court Clerk
John L. Turner	Sheriff
Ervine Allen	Property Valuation Administrator
Bobby G. Thorpe	Coroner

Appointed Personnel:

William K. Back	County Treasurer
Wanda K. Barnett	Occupational Tax Collector
Brenda Fugate	Finance Officer

BREATHITT COUNTY
STATEMENT OF NET ASSETS-MODIFIED CASH BASIS

June 30, 2005

BREATHITT COUNTY
STATEMENT OF NET ASSETS-MODIFIED CASH BASIS

June 30, 2005

	<u>Primary</u> <u>Governmental</u> <u>Governmental</u> <u>Activities</u>
ASSETS	
Current Assets:	
Cash and Cash Equivalents	\$ 2,249,764
Investments	415,700
Total Current Assets	<u>2,665,464</u>
Noncurrent Assets:	
Capital Assets-Net of Accumulated Depreciation	
Construction In Progress	6,271,968
Land	1,727,786
Buildings	5,820,814
Vehicles and Equipment	691,269
Infrastructure Assets-Net of Depreciation	420,608
Total Noncurrent Assets	<u>14,932,445</u>
Total Assets	<u>17,597,909</u>
LIABILITIES	
Current Liabilities:	
Bonds Payable	830,000
Financing Obligations Payable	38,279
Total Current Liabilities	<u>868,279</u>
Noncurrent Liabilities:	
Bonds Payable	7,735,000
Financing Obligations Payable	407,038
Total Noncurrent Liabilities	<u>8,142,038</u>
Total Liabilities	<u>9,010,317</u>
NET ASSETS	
Invested in Capital Assets, Net of Related Debt	5,922,128
Unrestricted	2,665,464
Total Net Assets	<u>\$ 8,587,592</u>

The accompanying notes are an integral part of the financial statements.

BREATHITT COUNTY
STATEMENT OF ACTIVITIES-MODIFIED CASH BASIS
For The Year Ended June 30, 2005

BREATHITT COUNTY
STATEMENT OF ACTIVITIES-MODIFIED CASH BASIS

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For The Year Ended June 30, 2005

Functions/Programs Reporting Entity	Program Revenue Received		Net (Expenses) Revenues and Changes in Net Assets	
			Primary Government	
	Expenses	Charges for Services	Operating Grants and Contributions	Governmental Activities
Primary Government:				
General Government	\$ 941,566	\$	\$ 134,656	\$ (806,910)
Protection to Persons and Property	865,705	3,006	512,728	(349,971)
General Health and Sanitation	199,856	72,816	129,898	2,858
Social Services	26,841		2,900	(23,941)
Recreation and Culture	17,094			(17,094)
Roads	1,146,221		1,781,336	635,115
Debt Service (Interest)	339,486		575,680	236,194
Administration	623,586			(623,586)
Total Government Activities	4,160,355	75,822	3,137,198	(947,335)
Total Primary Government	4,160,355	75,822	3,137,198	(947,335)
General Revenues:				
Taxes:				
Real Property Taxes				283,111
Motor Vehicle Tax				55,737
Tangible Taxes				441
Telephone Taxes(E-911)				91,219
Others Taxes				981,671
Excess Fees				39,914
Unrestricted Investment Earnings				41,679
Miscellaneous Revenue				174,693
Total General Revenues				1,668,465
Changes in Net Assets				721,130
Net Assets-Beginning (Restated)				7,866,462
Net Assets-Ending				\$ 8,587,592

The accompanying notes are an integral part of the financial statements.

BREATHITT COUNTY
BALANCE SHEET-GOVERNMENTAL FUNDS-MODIFIED CASH BASIS

June 30, 2005

BREATHITT COUNTY
BALANCE SHEET-GOVERNMENTAL FUNDS-MODIFIED CASH BASIS

June 30, 2005

	General Fund	Road Fund	Justice Center Corporation Bond Fund	General Obligation Refunding Bond Series 2003 Fund	Non- Major Funds	Total Governmental Funds
ASSETS						
Cash and Cash Equivalents	\$ 571,365	\$ 275,826	\$ 952,583	\$ 18,230	\$ 431,760	\$ 2,249,764
Investments				415,700		415,700
Total Assets	<u>\$ 571,365</u>	<u>\$ 275,826</u>	<u>\$ 952,583</u>	<u>\$ 433,930</u>	<u>\$ 431,760</u>	<u>\$ 2,665,464</u>
FUND BALANCES						
Reserved for:						
Encumbrances	\$ -	\$ -	\$ -	\$ -	\$ 39,345	\$ 39,345
Unreserved						
General Fund	571,365					571,365
Special Revenue Funds		275,826			392,415	668,241
Capital Projects Fund			952,583	433,930		1,386,513
Debt Service Fund						
Total Fund Balance	<u>\$ 571,365</u>	<u>\$ 275,826</u>	<u>\$ 952,583</u>	<u>\$ 433,930</u>	<u>\$ 431,760</u>	<u>\$ 2,665,464</u>

Reconciliation To Statement Of Net Assets

Total Fund Balances	\$ 2,665,464
Amounts reported for Government Activities in the Statement	
Of Net Assets are difference because:	
Capital Assets Used in Government Activities are not Financial	
Resources and therefore are not reported in the funds.	16,423,850
Accumulated Depreciation	(1,491,405)
Long-term debt is not due and payable in the current period and,	
therefore, is not reported in the funds.	
Financing Obligations	(445,317)
Bonded Debt	(8,565,000)
Net Assets Of Governmental Activities	<u>\$ 8,587,592</u>

The accompanying notes are an integral part of the financial statements.

BREATHITT COUNTY
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES-GOVERNMENTAL FUNDS-MODIFIED CASH BASIS

For The Year Ended June 30, 2005

BREATHITT COUNTY
STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES-GOVERNMENTAL FUNDS-MODIFIED CASH BASIS

For The Year Ended June 30, 2005

	General Fund	Road Fund	Justice Center Corporation Bond Fund	General Obligation Refunding Bond Series 2003 Fund	Non- Major Funds	Total Governmental Funds
REVENUES						
Taxes	\$1,320,961	\$ -	\$ -	\$ -	\$ 91,219	\$ 1,412,180
Excess Fees	39,914					39,914
Intergovernmental	134,656	1,473,875	575,680		952,987	3,137,198
Charges for Services					75,823	75,823
Miscellaneous	152,035	11,968			10,688	174,691
Interest	3,367	3,097	25,818	7,273	2,124	41,679
Total Revenue	<u>1,650,933</u>	<u>1,488,940</u>	<u>601,498</u>	<u>7,273</u>	<u>1,132,841</u>	<u>4,881,485</u>
EXPENDITURES						
General Government	875,863	908		1,065	43,349	921,185
Protection to Persons and Property	79,502				852,979	932,481
General Health and Sanitation					176,006	176,006
Social Services	26,841					26,841
Recreation and Culture	7,647				9,447	17,094
Roads		1,147,297			57,816	1,205,113
Debt Service:						
Principal		20,934	290,000	230,000	6,700	547,634
Interest	2,219	8,289	283,430	41,589	3,959	339,486
Capital Projects	150,000		3,821,158			3,971,158
Administration	417,342	137,631			68,613	623,586
Total Expenditures	<u>1,559,414</u>	<u>1,315,059</u>	<u>4,394,588</u>	<u>272,654</u>	<u>1,218,869</u>	<u>8,760,584</u>
Excess (Deficiency) of Revenue Over Expenditures Before Other Financing Sources (Uses)	<u>91,519</u>	<u>173,881</u>	<u>(3,793,090)</u>	<u>(265,381)</u>	<u>(86,028)</u>	<u>(3,879,099)</u>
Other Financing Sources (Uses)						
Capital Lease Proceeds-KACo	150,000					150,000
Transfer From Other Funds				244,000	416,975	660,975
Transfers to Other Funds	(228,000)	(216,000)			(216,975)	(660,975)
Total Other Financing Sources (Uses)	<u>(78,000)</u>	<u>(216,000)</u>		<u>244,000</u>	<u>200,000</u>	<u>150,000</u>
Net Change in Fund Balances	13,519	(42,119)	(3,793,090)	(21,381)	113,972	(3,729,099)
Fund Balances-Beginning	557,846	317,945	4,745,673	455,311	317,788	6,394,563
Fund Balances-Ending	<u>\$ 571,365</u>	<u>\$ 275,826</u>	<u>\$ 952,583</u>	<u>\$ 433,930</u>	<u>\$ 431,760</u>	<u>\$ 2,665,464</u>

The accompanying notes are an integral part of the financial statements.

**BREATHITT COUNTY
RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCES OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES-MODIFIED CASH BASIS**

For The Year Ended June 30, 2005

BREATHITT COUNTY
RECONCILIATION OF THE STATEMENTS OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCES OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES-MODIFIED CASH BASIS

For The Fiscal Year Ended June 30, 2005

Reconciliation to the Statement of Activities:

Net Change in Fund Balances - Total Governmental Funds	\$ (3,729,099)
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Governmental Funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets are allocated over their estimated useful lives and reported as depreciation expense.

Capital Outlay	4,198,884
Depreciation Expense	(136,889)
Disposal of Surplus Property, Net Book Value	(9,400)

Government Funds report Lease Proceeds (net) as other financing sources. However, in the Statement of Activities these are not shown as a revenue.	(150,000)
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Lease and bond principal payments are expended in the Governmental Funds as a use of current year financial resources. These transactions, however, have no effect on net assets.

Financing Obligations	27,634
Bond Payments	520,000

Change in Net Assets of Governmental Activities	<div style="border-top: 1px solid black; border-bottom: 3px double black; padding: 2px 0;">\$ 721,130</div>
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The accompanying notes are an integral part of the financial statements.

**INDEX FOR NOTES
TO THE FINANCIAL STATEMENTS**

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BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2005

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation

The county presents its government-wide and fund financial statements in accordance with a modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Under this basis of accounting, assets, liabilities, and related revenues and expenditures are recorded when they result from cash transaction, with few exceptions. This modified cash basis recognizes revenues when received and expenditures when paid. Property tax receivables, accounts payable, compensated absences, and donated assets are not reflected in the financial statements.

Encumbrances lapse at year-end and are not reflected on the Statement of Net Assets and Statement of Activities; however encumbrances are reflected on the Balance Sheet-Governmental Funds as part of the fund balance (Reserved for Encumbrances).

The State Local Finance Officer does not require the county to report capital assets and infrastructure; however the value of assets are included in the Statement of Net Assets and their corresponding depreciation expense is included on the Statement of Activities.

B. Reporting Entity

The financial statements of Breathitt County include the funds, agencies, boards, and entities for which the fiscal court is financially accountable. Financial accountability, as defined by Section 2100 of the Governmental Accounting Standards Board (GASB) Codification of Governmental Accounting and Financial Reporting Standards, as amended by GASB 14 and GASB 39, was determined on the basis of the government's ability to significantly influence operations, select the governing authority, participate in fiscal management and the scope of public service. Consequently, the entity includes a organization that is legally separate from the primary government. Legally separate organizations are reported as component units if either the county is financially accountable or the organization's exclusion would cause the county's financial statements to be misleading or incomplete. Component units may be blended or discretely presented. Blended component units either provide their services exclusively or almost entirely to the primary government, or their governing bodies are substantively the same as the primary government. Based upon the criteria stated in GASB 14 and GASB 39, management has included the Breathitt County Public Properties Courthouse Corporation as part of the reporting entity.

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2005
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

C. Breathitt County Constitutional Elected Officials

The Kentucky constitution provides for election of the above officials from the geographic area constituting Breathitt County. Pursuant to state statute, these officials perform various services for the Commonwealth of Kentucky, its judicial courts, the fiscal court, various cities and special districts within the county, and the board of education. In exercising these responsibilities, however, they are required to comply with state laws. Audits of their financial statements are issued separately and individually and can be obtained from their respective administrative offices. These financial statements are not required to be included in the financial statements of Breathitt County, Kentucky.

- Circuit Court Clerk
- County Attorney
- County Clerk
- County Sheriff
- Property Valuation Administrator

D. Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the non-fiduciary activities of the primary government and its component unit. For the most part, the effect of inter-fund activities has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on sales, fees, and charges for support. Business-type revenues come mostly from fees charged to external parties for goods or services. Fiduciary funds are not included in these financial statements due to the unavailability of fiduciary funds to aid in the support of government programs. The County does not have any business-type activities.

The statement of net assets presents the reporting entity's non-fiduciary assets and liabilities, the difference between the two being reported as net assets. Net assets are reported in three categories: 1) invested in capital assets, net of related debt - consisting of capital assets, net of accumulated depreciation and reduced by outstanding balances for debt related to the acquisition, construction, or improvement of those assets; 2) restricted net assets - resulting from constraints placed on net assets by creditors, grantors, contributors, and other external parties, including those constraints imposed by law through constitutional provisions or enabling legislation; and 3) unrestricted net assets - those assets that do not meet the definition of restricted net assets or invested in capital assets.

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2005
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

D. Government-wide and Fund Financial Statements (Continued)

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include 1) charges to customers or applicants who purchase, use or directly benefit from goods, services, or privileges provided by a given function and 2) operating grants and contributions and 3) capital grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Internal dedicated resources such as taxes and other unrestricted state funds are reported as general revenues.

Funds are characterized as either major or non-major. Majors funds are those whose assets, liabilities, revenues, or expenditures/expenses are at least ten percent of the corresponding total (assets, liabilities, etc.) for all funds or type (governmental or proprietary funds) and whose total assets, liabilities, revenues, or expenditures/expenses are at least five percent of the corresponding total for all governmental and enterprise funds combined. The fiscal court may also designate any fund as a major fund.

Separate financial statements are provided for governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements.

Governmental Funds

The primary government reports the following major governmental funds:

General Fund – This is the primary operating fund of the Fiscal Court. It accounts for all financial resources of the general government, except where the Department for Local Government requires a separate fund or where management requires that a separate fund be used for some function.

Road Fund - This fund is for road and bridge construction and repair. The primary source of revenue for this fund is state payments for truck licenses distribution, municipal road aid, and transportation grants. The Governor's Office for Local Development requires the fiscal court to maintain these receipts and expenditures separately from the General Fund.

Justice Center Corporation Bond Fund– The Justice Center Corporation accounts for the activities of the Breathitt County Justice Center Corporation, a blended component unit of the county. The Breathitt County Justice Center issued debt to build facilities and additions to the justice center. The Breathitt County Justice Center Corporation entered into a contract, lease, and option with the County and Administrative Office of the Courts (AOC), Commonwealth of Kentucky. The Governor's Office for Local Development does not require the fiscal court to report or budget these funds.

General Obligation Series 2003 Bond Fund-The purpose of this fund is to account for debt service requirements of general obligation bonds of the county. The Governor's Office for Local Development does not require the fiscal court to report or budget these funds.

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2005
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

D. Government-wide and Fund Financial Statements (Continued)

Governmental Funds (Continued)

The primary government also has the following non-major funds: Jail Fund, Local Government Economic Assistance Fund, Community Development Block Grant Fund, Disaster and Emergency Service Fund, Solid Waste Fund, E-911 Fund and Local Government Economic Assistance Development Fund.

Special Revenues Funds:

The Road Fund, Jail Fund, Local Government Economic Assistance Fund, Community Development Block Grant Fund, Disaster and Emergency Service Fund, Solid Waste Fund, E-911 Fund and Local Government Economic Assistance Development Fund are presented as special revenue funds. Special revenue funds are to account for the proceeds of specific revenue sources and expenditures that are legally restricted for specific purposes.

Capital Projects Fund:

The Breathitt County Kentucky Justice Center Corporation Bond Fund is presented as a capital projects fund. Capital Projects funds are to accounts for the financial resources to be used for the acquisition or construction of major capital facilities. However, for fiscal year ended June 30, 2005 some debt service obligations related to this project were paid from this fund.

Debt Service Fund:

The General Obligation Series 2003 Bond Fund is presented as a debt service fund. Debt service funds are to account for the accumulation of resources for, and the payment of general long-term debt principal and interest.

Generally and except as otherwise provided by law, property taxes are assessed as of January 1, levied (mailed) November 1, due at discount November 30, due at face value December 30, delinquent January 1, following the assessment, and subject to lien and sale the 3rd Saturday in April following the delinquency date.

E. Deposits and Investments

The government's cash and cash equivalents are considered to be cash on hand, demand deposits, certificate of deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

KRS 66.480 authorizes the county to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United State government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2005
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

F. Capital Assets

Capital assets, which include land, land improvements, buildings, furniture and office equipment, building improvements, machinery, equipment, and infrastructure assets (road and bridges) that have a useful life of more than one reporting period based on the government's capitalization policy, are reported in the applicable governmental or business-type activities of the government-wide financial statements. Such assets are recorded at historical cost or estimated historical cost when purchased or constructed.

Cost of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's life are not capitalized. Land and Construction In Progress is not depreciated. Interest incurred during construction is not capitalized. Capital assets and infrastructure are depreciated using the straight-line method of depreciation over the estimated useful life of the asset.

	Capitalization Threshold	Useful Life (Years)
Land Improvements	\$ 12,500	10-60
Buildings	25,000	10-75
Building Improvements	25,000	10-75
Machinery and Equipment	2,500	3-25
Vehicles	2,500	3-5
Infrastructure	20,000	10-50

G. Long-Term Obligations

In the government-wide financial statements and proprietary fund types in the fund financial statements, long term debt and other long-term obligations are reported as liabilities in the applicable financial statements. The principal amount of bond notes and financing obligations are reported.

In the fund financial statements, governmental fund types recognize bond interest, as well as bond issuance costs when received or when paid, during the current period. The principal amount of the debt and interest is reported as expenditures. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures. Debt proceeds are reported as other financing sources.

H. Fund Equity

In the fund financial statements, the difference between the assets and liabilities of governmental funds is reported as fund balance. Fund balance is divided into reserved and unreserved components, with unreserved considered available for new spending. Unreserved fund balances, may be divided into designated and undesignated portions. Designations represent fiscal court's intended use of the resources and should reflect actual plans approved by the fiscal court.

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2005
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

H. Fund Equity (Continued)

Governmental funds report reservations of fund balance for amounts that are legally restricted by outside parties for use for a specific purpose, long-term receivables, and encumbrances.

“Reserved for Encumbrances” are purchase orders that will be fulfilled in a subsequent fiscal period. Although the purchase order or contract creates a legal commitment, the fiscal court incurs no liability until performance has occurred on the part of the party with whom the fiscal court has entered into the arrangement. When a government intends to honor outstanding commitments in subsequent periods, such amounts are encumbered. Encumbrances lapse at year-end and are not reflected on the statement of net assets and statement of activities, however encumbrances are reflected on the Balance Sheet – Governmental Funds as part of the Fund Balance.

I. Budgetary Information

Annual budgets are adopted on a cash basis of accounting and according to the laws of Kentucky as required by the State Local Finance Officer. Formal budgets are not adopted for the Jail Canteen Fund.

The State Local Finance Officer does not require the Jail Canteen fund to be budgeted because the fiscal court does not approve the expenses made from these funds.

The County Judge/executive is required to submit estimated receipts and proposed expenditures to the fiscal court by May 1 of each year. The budget is prepared by fund, function, and activity and is required to be adopted by the fiscal court by July 1.

The fiscal court may change the original budget by transferring appropriations at the activity level; however, the fiscal court may not increase the total budget without approval by the State Local Finance Officer. Expenditures may not exceed budgeted appropriations at the activity level.

J. Related Organization, Joint Ventures, and Joint Governed Organizations

Related Organization

A related organization is an entity for which a primary government is not financially accountable. It does not impose will or have a financial benefit or burden relationship, even if the primary government appoints a voting majority of the related organization’s governing board. Based on these criteria, the following is considered a related organization of the Breathitt County Fiscal Court: Breathitt County Industrial Foundation.

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2005
(Continued)

J. Related Organization, Joint Ventures, and Joint Governed Organizations (Continued)

Jointly Governed Organizations

A jointly governed organization is an entity that results from a multi-governmental arrangement that is governed by representatives from each participating government. The entity provides services to the citizens of each participating government, but there is no ongoing financial interest or responsibility by the participating governments. The jointly governed organization can act independently of each of the participating governments. The Jackson/Breathitt County Airport Board meets the criteria noted above and is an organization jointly governed by Breathitt County and the City of Jackson.

Note 2. Deposits and Investments

A. Deposits

The county maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC) in accordance with KRS 66.480(1)(d). According to KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the county and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution. These requirements were met.

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the government's deposits may not be returned. The government follows the requirements of KRS 41.240(4) and does not have a deposit policy for custodial risk. As February 22, 2005 and June 30, 2005, the County's deposits of \$1,993,270 and \$1,471,997 were exposed to custodial credit risk as follows:

- Uncollateralized and uninsured \$693,270 – 2/22/05
- Uncollateralized and uninsured \$171,997 – 6/30/05

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2005
(Continued)

Note 2. Deposits and Investments (Continued)

B. Investments

The county's investments are categorized below to give an indication of the level of risk assumed by the county at year-end. Category 1 includes investments that are insured or registered or the securities are held by the county or by the county's agent in the county's name. Category 2 includes uninsured and unregistered investments where the securities are held by the financial institution in the county's name. Category 3 includes uninsured and unregistered investments where the securities were held by the financial institution, but not in the county's name.

Investments	Category			Carrying Amounts	Market Value
	1	2	3		
Primary Government:					
Governmental					
Securities	\$ 415,700	\$	\$	\$ 415,700	\$ 415,700

Note 3. Financing Obligations

The fiscal court entered into various lease agreements for road equipment and redesign of the new judicial center. The County and the City of Jackson also entered into an unsecured guaranty agreement with the First National Bank. The agreements stipulates that the County and the City of Jackson will guarantee payments of a loan that was entered into by the Jackson/ Breathitt Airport Board. The County and the City of Jackson each pay \$500 monthly to the First National Bank for these payments. The total principal and interest lease expense for the fiscal year ended June 30, 2005 was \$37,992. The future minimum lease payments for these leases are as follows:

Fiscal Year Ended June 30	Governmental Activities
2006	\$ 60,922
2007	102,448
2008	93,984
2009	93,287
2010	93,287
2011-2015	225,840
2016-2020	35,769
Total Minimum Lease Payments	\$ 705,537
Less: Amount Representing Interest	260,220
Present Value of Minimum Lease Payments	\$ 445,317

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2005
(Continued)

Note 4. Capital Assets

Capital assets activity for the year ended June 30, 2005 was as follows:

	Reporting Entity			
	Beginning Balance	Increases	Decreases	Ending Balance
<u>Governmental Activities:</u>				
Capital Assets Not Being Depreciated:				
Land	\$ 1,727,786	\$	\$	\$ 1,727,786
Construction In Progress	2,300,810	3,971,158		6,271,968
Total Capital Assets Not Being Depreciated	4,028,596	3,971,158		7,999,754
Capital Assets Being Depreciated:				
Buildings	6,825,500			6,825,500
Vehicles and Equipment	1,080,325	107,330	(47,000)	1,140,655
Infrastructure	337,545	120,396		457,941
Capital Assets Being Depreciated	8,243,370	227,726	(47,000)	8,424,096
Less Accumulated Depreciation For:				
Building	(954,731)	(49,955)		(1,004,686)
Vehicles and Equipment	(421,499)	(65,487)	37,600	(449,386)
Infrastructure	(15,886)	(21,447)		(37,333)
Total Accumulated Depreciation	(1,392,116)	(136,889)	37,600	(1,491,405)
Total Capital Assets Being Depreciated, Net	6,851,254	90,837	(9,400)	6,932,691
Government Activities Capital Assets, Net	\$10,879,850	\$ 4,061,995	\$ (9,400)	\$14,932,445

Depreciation expense was charged to functions of the primary government as follows:

<u>Governmental Activities:</u>	
General Government	\$ 20,381
Protection to Persons and Property	40,554
General Health and Sanitation	23,850
Roads, Including Depreciation of General Infrastructure Assets	52,104
Total Depreciation Expense – Governmental Activities	<u>\$ 136,889</u>

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2005
(Continued)

Note 4. Capital Assets (Continued)

Breathitt County has valued all capital assets using estimated historical costs. The county is only counting infrastructure placed in service on or after July 1, 2003, and did not report any infrastructure placed in service prior to July 1, 2003.

Note 5. Long-Term Debt

A. Public Project Revenue Bonds (Jail Project), Series 1996

In February 1996, the Breathitt County Public Properties Corporation, a component unit of the Breathitt County Fiscal Court, issued \$445,000 in Public Project Revenue Bonds for the cost of renovating the existing county detention center. These bonds were originally scheduled to mature in February 2016. As part of refunding, the Jail Bonds payment schedule was revised to reflect a maturity date of February 1, 2006. The bond principal and interest payments will be paid from the proceeds of the General Obligation Refunding Bonds, Series 2003. As of June 30, 2005, the principal balance outstanding on the 1996 Jail Bonds was \$390,000.

Fiscal Year Ended:

<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>
2006	<u>\$ 390,000</u>	<u>\$ 24,163</u>

B. First Mortgage Revenue Bonds (Justice Center Project), Series 2003

On April 1, 2003, the Breathitt County, Kentucky Justice Center Corporation issued bonds in order to construct a new Justice Center. On the same day, the Breathitt County, Justice Center Corporation, Administrative Office of the Courts (AOC), and the county entered into a lease agreement for the purpose of obtaining office rental space for the AOC at the Justice Center.

The Breathitt County Kentucky, Justice Center Corporation is acting as an agent for AOC in order to plan, design, construct, manage, and maintain the Justice Center. The Breathitt County, Kentucky Justice Center Corporation expects annual rentals for use of the Justice Center to be in the full amount of the annual principal and interest requirements of the bonds. Under the terms of the lease, the AOC has agreed to pay directly to the paying agent bank, the use allowance payment as provided in the lease. The lease agreement is renewable every two years. The Breathitt County, Kentucky Justice Center Corporation is in reliance upon the use allowance payments in order to meet the debt service for the bonds.

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2005
(Continued)

Note 5. Long-Term Debt (Continued)

B. First Mortgage Revenue Bonds (Justice Center Project), Series 2003 (Continued)

The use allowance payment commences with occupancy of the Judicial Building by the Administrative Office of the Courts. The Administrative Office of the Courts with the execution of the lease has expressed its intention to pay the full use allowance payment in each successive biennial budget for a period of twenty years, but the lease does not legally obligate the Administrative Office of the Courts to do so. As of June 30, 2005, the principal balance outstanding was \$7,740,000. Debt service requirements for fiscal years ending June 30, 2006, and thereafter are as follows:

<u>Fiscal Year Ended June 30</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ 295,000	\$ 283,430
2007	305,000	274,655
2008	315,000	265,695
2009	325,000	256,355
2010	335,000	236,855
2011-2015	1,845,000	1,009,076
2016-2020	2,210,000	644,668
2021-2024	<u>2,110,000</u>	<u>173,200</u>
Total	<u>\$ 7,740,000</u>	<u>\$ 3,143,934</u>

C. General Obligation Refunding Bond, Series 2003

On July 1, 2003, the County issued \$865,000 in General Obligation Refunding Bonds, Series 2003. The proceeds from these refunding bonds were used to refinance the Breathitt County Public Properties Corporation Series 1994 Road bonds, the Breathitt County Public Properties Corporation Series 1996 Jail bonds, and a 1998 capital lease for a grader. These bonds are scheduled to mature in February 2016; interest payments are due every six months starting in February 2004 and principal payments are due annually beginning in February 2004. At June 30, 2005, the principal balance outstanding on these bonds was \$435,000. Debt service requirements for fiscal years ending June 30, 2006, and thereafter are as follows:

<u>Fiscal Year Ended June 30</u>	<u>Principal</u>	<u>Interest</u>
2006	\$ 145,000	\$ 12,839
2007	25,000	9,939
2008	25,000	9,139
2009	25,000	8,339
2010	30,000	7,539
2011-2015	165,000	21,805
2016	<u>20,000</u>	<u>725</u>
Total	<u>\$ 435,000</u>	<u>\$ 70,325</u>

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2005
(Continued)

Note 5. Long-Term Debt (Continued)

D. Changes in Long-Term Liabilities

Long-term liability activity for the year ended June 30, 2005, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<u>Governmental Activities</u>					
General Obligation Bonds	\$ 650,000	\$	\$ 215,000	\$ 435,000	\$ 145,000
Revenue Bonds	8,435,000		305,000	8,130,000	685,000
Financing Obligations	322,951	150,000	27,634	445,317	38,279
Governmental Activities- Long-Term Liabilities	<u>\$ 9,407,951</u>	<u>\$ 150,000</u>	<u>\$ 547,634</u>	<u>\$ 9,010,317</u>	<u>\$ 868,279</u>

Note 6. Interest On Long-Term Debt and Financing Obligations

Debt Service on the Statement of Activities includes \$14,467 in interest on financing obligations and \$325,019 in interest on bonds.

Note 7. Employee Retirement System

The county has elected to participate in the County Employees Retirement System (CERS), pursuant to KRS 78.530 administered by the Board of Trustees of the Kentucky Retirement Systems. This is a cost-sharing multiple-employer defined benefit pension plan, which covers all eligible full-time employees and provides for retirement, disability, and death benefits to plan members. Benefit contributions and provisions are established by statute. Non-hazardous covered employees are required to contribute 5 percent of their salary to the plan. The county's contribution rate for non-hazardous employees was 8.48 percent.

Benefits fully vest on reaching five years of service for non-hazardous employees. Aspect of benefits for non-hazardous employees includes retirement after 27 years of service or age 65.

Historical trend information showing the CERS' progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Retirement Systems' annual financial report. This report may be obtained by writing the Kentucky Retirement Systems, 1260 Louisville Road, Frankfort, KY 40601-6124, or by telephone at (502) 564-4646.

Note 8. Prior Period Adjustments

The beginning cash balances for all funds were adjusted by a total of \$12,949 due to prior year outstanding checks voided.

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2005
(Continued)

Note 9. Insurance

For the fiscal year ended June 30, 2005, Breathitt County was a member of the Kentucky Association of Counties' All Lines Fund (KALF). KALF is a self-insurance fund and was organized to obtain lower cost coverage for general liability, property damage, public officials' errors and omissions, public liability, and other damages. The basic nature of a self-insurance program is that of a collectively shared risk by its members. If losses incurred for covered claims exceed the resources contributed by the members, the members are responsible for payment of the excess losses.

BREATHITT COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplementary Information - Modified Cash Basis
For The Year Ended June 30, 2005

BREATHITT COUNTY
BUDGEARY COMPARISON SCHEDULES-MAJOR FUNDS
Required Supplemental Information
Modified Cash Basis

For The Year Ended June 30, 2005

	GENERAL FUND			
	Budgeted Amounts		Actual	Variance with
	Original	Final	Amount, (Budgetary Basis)	Final Budget Positive (Negative)
REVENUES				
Taxes	\$ 1,213,195	\$ 1,367,293	\$ 1,320,961	(46,332)
Excess Fees		39,914	39,914	
Intergovernmental Revenues	66,900	157,808	134,656	(23,152)
Miscellaneous	123,300	150,898	152,035	1,137
Interest	1,500	2,962	3,367	405
Total Revenues	1,404,895	1,718,875	1,650,933	(67,941)
EXPENDITURES				
General Government	880,965	1,031,492	875,863	155,629
Protection to Persons and Property	53,398	81,860	79,502	2,358
Social Services	30,000	33,885	26,841	7,044
Recreation and Culture		7,647	7,647	
Debt Service:				
Interest		2,219	2,219	
Administration	499,405	752,435	417,342	335,093
Total Expenditures	1,463,768	1,909,538	1,409,414	500,124
Excess (Deficiency) of Revenues Over Expenditures Before Other Financing Sources (Uses)	(58,873)	(190,663)	241,519	432,183
OTHER FINANCING SOURCES (USES)				
Transfers From Other Fund	100,000	100,000		(100,000)
Transfers To Other Funds	(421,825)	(421,825)	(228,000)	193,825
Total Other Financing Sources and (Uses)	(321,825)	(321,825)	(228,000)	93,825
Net Changes in Fund Balances	(380,698)	(512,488)	13,519	526,008
Fund Balance-Beginning	380,698	564,088	557,846	(6,242)
Funding Balance-Ending	\$	\$ 51,600	\$ 571,365	\$ 519,766

BREATHITT COUNTY
BUDGETARY COMPARISON SCHEDULES-MAJOR FUNDS
Required Supplemental Information
Modified Cash Basis
For The Year Ended June 30, 2005 (Continued)

ROAD FUND				
	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts, (Budgetary Basis)	Final Budget Positive (Negative)
REVENUES				
Intergovernmental	\$ 1,324,673	\$ 1,529,857	\$ 1,473,875	\$ (55,982)
Miscellaneous	1,000	11,969	11,968	(1)
Interest	2,500	2,750	3,097	347
Total Revenues	1,328,173	1,544,576	1,488,940	(55,636)
EXPENDITURES				
General Government	5,000	5,000	908	4,092
Roads	1,018,032	1,478,384	1,157,231	321,153
Debt Service:				
Principal	216,000	216,000	12,076	203,924
Interest	6,801	7,213	7,213	
Administration	217,340	190,971	137,631	53,340
Total Expenditures	1,463,173	1,897,568	1,315,059	582,509
Excess (Deficiency) of Revenues Over Expenditures Before Other Financing Sources (Uses)	(135,000)	(352,992)	173,881	526,873
OTHER FINANCING SOURCES (USES)				
Transfers From Other Fund	100,000	100,000		(100,000)
Transfers To Other Funds	(100,000)	(100,000)	(216,000)	(116,000)
Total Other Financing Sources and (Uses)			(216,000)	(216,000)
Net Changes in Fund Balances	(135,000)	(352,992)	(42,119)	310,873
Fund Balances Beginning	135,000	301,392	317,945	16,553
Fund Balances-Ending	\$	\$ (51,600)	\$ 275,826	\$ 327,426

BREATHITT COUNTY
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

June 30, 2005

1. Budgetary Information

Annual budgets are adopted on a cash basis of accounting and according to the laws of Kentucky as required by the State Local Finance Officer.

The County Judge/Executive is required to submit estimated receipts and proposed expenditures to the fiscal court by May 1 of each year. The budget is prepared by fund, function, and activity and is required to be adopted by the fiscal court by July 1.

The fiscal court may change the original budget by transferring appropriations at the activity level; however, the fiscal court may not increase the total budget without approval by the State Local Finance Officer. Expenditures may not exceed budgeted appropriations at the activity level.

2. Reconciliation of General Fund

The general fund budgetary statement does not include \$150,000 in capital projects expenditure and \$150,000 in debt proceeds that are included on the Statement of Revenues, Expenditures, and Changes in Fund Balance.

**BREATHITT COUNTY
COMBINING BALANCE SHEET -
NON-MAJOR GOVERNMENTAL FUNDS - MODIFIED CASH BASIS
Other Supplementary Information**

June 30, 2005

BREATHITT COUNTY
COMBINING BALANCE SHEET-
NON-MAJOR GOVERNMENTAL FUNDS-MODIFIED CASH BASIS
Other Supplementary Information

June 30, 2005

	Jail Fund	Local Government Economic Assistance Fund	Disaster and Emergency Service Fund	Solid Waste Fund	E-911 Fund	Local Government Economic Assistance Development Fund	Total Non-Major Governmental Funds
ASSETS							
Cash	\$ 25,099	\$ 104,859	\$ 84,579	\$ 109,999	\$ 104,709	\$ 2,515	\$ 431,760
Total Assets	\$ 25,099	\$ 104,859	\$ 84,579	\$ 109,999	\$ 104,709	\$ 2,515	\$ 431,760
FUND BALANCES							
Fund Balances:							
Reserved for:							
Encumbrances	\$ -	\$ -	\$ 39,345	\$ -	\$ -	\$ -	\$ 39,345
Unreserved-Special Revenue Funds	25,099	104,859	45,234	109,999	104,709	2,515	392,415
Total Fund Balance	\$ 25,099	\$ 104,859	\$ 84,579	\$ 109,999	\$ 104,709	\$ 2,515	\$ 431,760

BREATHITT COUNTY
COMBINING STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES-NON-MAJOR GOVERNMENTAL FUNDS-
MODIFIED CASH BASIS
Other Supplementary Information
For The Year Ended June 30, 2005

BREATHITT COUNTY
COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCES-NON-MAJOR GOVERNMENTAL FUNDS-MODIFIED CASH BASIS
Other Supplementary Information

Fiscal Year Ended June 30, 2005

	Jail Fund	Local Government Economic Assistance Fund	Community Development Block Grant Fund	Disaster and Emergency Service Fund	Solid Waste Fund	E-911 Fund	Local Government Economic Assistance Development Fund	Total Non-Major Governmental Funds
REVENUES								
Taxes	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 91,219	\$ -	\$ 91,219
Intergovernmental	95,173	344,334	2,900	417,555	93,025			952,987
Charges For Services	3,007				72,816			75,823
Miscellaneous	1,461	319			8,908			10,688
Interest	177	776			593	578		2,124
Total Revenue	99,818	345,429	2,900	417,555	175,342	91,797		1,132,841
EXPENDITURES								
General Government		43,349						43,349
Protection to Persons and Property	441,735			348,408	145,912	62,836		852,979
General Health and Sanitation		30,094						176,006
Recreation and Culture		9,447						9,447
Roads		57,816						57,816
Debt Service:								
Principal	4,010	2,690						6,700
Interest	99	3,860						3,959
Administration	27,848	19,601	2,900		10,868	7,396		68,613
Total Expenditures	473,692	166,857	2,900	348,408	156,780	70,232		1,218,869
Excess (Deficiency) of Revenue Over Expenditures Before Other Financing Sources (Uses)	(373,874)	178,572		69,147	18,562	21,565		(86,028)
OTHER FINANCING SOURCES (USES)								
Transfer From Other Funds	416,975							416,975
Transfers To Other Funds	(28,000)	(188,975)						(216,975)
Total Other Financing Sources (Uses)	388,975	(188,975)						200,000
Net Change in Fund Balances	15,101	(10,403)		69,147	18,562	21,565		113,972
Fund Balances-Beginning	9,998	115,262		15,432	91,437	83,144	2,515	317,788
Fund Balances-Ending	\$ 25,099	\$ 104,859	\$ -	\$ 84,579	\$ 109,999	\$ 104,709	\$ 2,515	\$ 431,760

BREATHITT COUNTY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For The Year Ended June 30, 2005

**BREATHITT COUNTY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

Fiscal Year Ended June 30, 2005

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an unqualified opinion on the governmental activities, each major fund, and the aggregate remaining fund information of Breathitt County.
2. No reportable conditions relating to the audit of the financial statement are reported in the Independent Auditor's Report.
3. No reportable conditions relating to the audit of the major federal awards programs are reported in the Independent Auditor's Report.
4. The auditor's report on compliance for the audit of the major federal awards programs for Breathitt County expresses an unqualified opinion.
5. There are no audit findings relative to the major federal awards programs of Breathitt County reported in Part C of this schedule.
6. The programs tested as a major programs were: Community Development Block Grant CFDA # 14.228; Disaster and Emergency Assistance Grant CFDA # 97.004; Public Assistance (FEMA Disaster) CFDA # 97.036.
7. The threshold for distinguishing Type A and B programs was \$300,000
8. Breathitt County was not determined to be a low-risk auditee.

B. FINDINGS-FINANCIAL STATEMENT AUDIT

None

C. FINDINGS AND QUESTIONED COSTS-MAJOR FEDERAL AWARDS PROGRAM AUDIT

None

D. PRIOR YEAR FINDINGS

- 1) Financial Audit:
 - a) The County Treasurer Should Prepare Bank Reconciliations For The Payroll Account.
 - b) The County Should Enter Into Written Agreements With Depository Institutions to Protect Deposits.
- 2) Major Federal Awards Program Audit:
 - a) The County Should Monitor Davis-Bacon Act Requirements As Applicable To Federal Programs
 - b) The County Should Require All Vendors Related To Federal Awards To Submit Suspension And Debarment Certifications.

BREATHITT COUNTY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

BREATHITT COUNTY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Fiscal Year Ended June 30, 2005

<u>Program Title</u>	<u>Federal CFDA No.</u>	<u>Disbursements</u>	
U.S Department of Commerce			
<i>Passed through NOAA</i>			
PRIDE Cleanup	11.469	\$ 57,013	
U.S Department of Housing & Urban Development			
<i>Passed Through Kentucky Dept of Local Government</i>			
Community Development Block Grant (Life Skills Center)	14.228	2,900	***
U.S. Department of Homeland Security			
<i>Passed through Ky Dept of Military Affairs</i>			
Disaster & Emergency Assistance Grant	97.004	348,408	***
Disaster & Emergency Assistance Grant - Planning	97.004	2,500	
Emergency Management Performance Grant	97.042	11,413	
Public Assistance Grants:			
FEMA 1471 - Severe Storm	97.036	40,959	***
FEMA 1475 - Severe Storm	97.036	75,749	
FEMA 1523 - Severe Storm	97.036	155,084	
Total U.S. Department of Homeland Security		634,113	
TOTAL FEDERAL EXPENDITURES		\$ 694,026	

Tested as Major Program ***

See accompanying notes to schedule of expenditures of federal awards

BREATHITT COUNTY
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2005

NOTE A – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal activity of the Lawrence County Fiscal Court and is presented on the modified-cash basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from the amounts presented in, or used in the preparation of, the basic financial statements.

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

ROSS & COMPANY, PLLC
Certified Public Accountants
800 Envoy Circle
Louisville, KY 40299
Telephone (502) 499-9088
Facsimile (502) 499-9132
www.rosscpas.com

The Honorable Lewis H. Warrix, Breathitt County Judge/Executive
Members of the Breathitt County Fiscal Court

Report on Internal Control Over Financial Reporting And on
Compliance And Other Matters Based on an Audit Of Financial
Statements Performed In Accordance With Governmental Auditing Standards

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Breathitt County, Kentucky as of and for the year ended June 30, 2005, which collectively comprise the County's basic financial statements, as listed in the table of contents and have issued our report thereon dated April 3, 2006. Breathitt County's financial statements are prepared in accordance with a basis of accounting other than generally accepted accounting principles. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Breathitt County's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Breathitt County's financial statements as of June 30, 2005, are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Report on Internal Control Over Financial Reporting And on
Compliance And Other Matters Based on an Audit Of Financial
Statements Performed In Accordance With Governmental Auditing Standards
(Continued)

This report is intended solely for the information and use of management and the Kentucky Governor's Office of Local Development and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Ross & Company", written in a cursive style.

Ross & Company PLLC

Audit fieldwork completed-
April 3, 2006

**REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

ROSS & COMPANY, PLLC
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800 Envoy Circle
Louisville, KY 40299-1837
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Facsimile (502) 499-9132
www.rosscpas.com

The Honorable Lewis H. Warrix, Breathitt County Judge/Executive
Members of the Breathitt County Fiscal Court

Report On Compliance With Requirements Applicable
To Each Major Program And Internal Control Over
Compliance In Accordance With OMB Circular A-133

Compliance

We have audited the compliance of Breathitt County with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2005. Breathitt County's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Breathitt County's management. Our responsibility is to express an opinion on Breathitt County's compliance based on our audit.

We conducted our audit of compliance in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above, that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Breathitt County's compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Breathitt County's compliance with those requirements.

In our opinion Breathitt County complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2005.

Internal Control Over Compliance

The management of Breathitt County is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Breathitt County's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

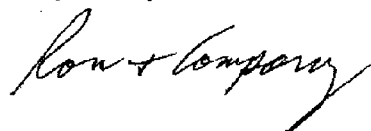
Report On Compliance With Requirements
Applicable To Each Major Program And On Internal Control
Over Compliance In Accordance With OMB Circular A-133
(Continued)

Internal Control Over Compliance (Continued)

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended for the information of management, federal awarding agencies and pass-through agencies and is not intended to be and should not be used by anyone other than the specified parties.

Respectively Submitted,

A handwritten signature in black ink, appearing to read "Ross & Company", written in a cursive style.

Ross & Company, PLLC

Audit Fieldwork Completed -
April 3, 2006

**CERTIFICATION OF COMPLIANCE –
LOCAL GOVERNMENT ECONOMIC ASSISTANCE PROGRAM**

BREATHITT COUNTY FISCAL COURT

**For The Fiscal Year Ended
June 30, 2005**


CERTIFICATION OF COMPLIANCE
LOCAL GOVERNMENT ECONOMIC ASSISTANCE PROGRAM
BREATHITT COUNTY FISCAL COURT

For the Fiscal Year Ended June 30, 2005

The Breathitt County Fiscal Court hereby certifies that assistance received from the Local Government Economic Assistance Program was expended for the purpose intended as dictated by the applicable Kentucky Revised Statutes.



Name
County Judge Executive



Name
County Treasurer